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Santa Clarita Valley Enterprise Zone
Audit

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Santa Clarita Valley Enterprise Zone Audit

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ENTERPRISE ZONE OVERVIEW

The State Enterprise Zone (EZ) Program represents California's primary economic development program. Eligibility for EZ designation is limited to jurisdictions that can demonstrate needs related to economic conditions, such as high poverty or unemployment rates. The original hypothesis behind the EZ program is that by targeting significant economic incentives to disadvantaged communities, these communities will be more effective in competing for new businesses and retaining existing businesses. The anticipated results are increased tax revenues, less reliance on social services, and lower public safety costs. Residents and businesses directly benefit from these more sustainable economic conditions through improved neighborhoods, business expansion, and job creation.

The State Department of Housing and Community Development (HCD) is responsible for the EZ designation process and program oversight. The EZ Program, after designation, is a 15-year partnership between local governments, government agencies, non-governmental agencies and private businesses to generate new private-sector investment and growth. To assist in this partnership, the State establishes a geographical area in which businesses may be eligible for exclusive State incentives and programs, which include the following:

- tax credits for sales and use taxes paid on qualified machinery;
- tax credits for hiring qualified employees;
- a 15-year net operating loss carry-forward;
- accelerated expense deductions; and
- priority for various State programs, such as State contracts.

In addition, California Revenue and Taxation Code Section 17053.74 governs the tax credit for a taxpayer who employs a qualified employee in an EZ. The tax credit is applied as follows:

- 50 percent of qualified wages in the first year of employment.
- 40 percent of qualified wages in the second year of employment.
- 30 percent of qualified wages in the third year of employment.
- 20 percent of qualified wages in the fourth year of employment.
- 10 percent of qualified wages in the fifth year of employment.
- Cap on EZ employment tax credit of \$37,440.

By statute, all EZs are required to report on their activities relative to their goals, objectives, and commitments as stated in the application for designation and HCD's MOU with the EZ. HCD has the authority to audit, at least once every five years, any designated EZ during the duration of the designation. In addition, HCD shall, for each audit, determine a result of superior, pass, or fail, per California Government Code 7076.1.

Santa Clarita Valley Enterprise Zone Audit

Introduction

Santa Clarita Valley Enterprise Zone (SCVEZ) is one of 40 EZs in California providing tax incentives to qualified businesses. Since its inception in 2007, the originally named “Santa Clarita Enterprise Zone Program” has helped 345 Santa Clarita businesses save an estimated \$199 million on their State taxes and created more than 976 new jobs in the community, per SCVEZ’s website. In April 2012, SCVEZ announced that it received a final designation effective January 1, 2011 through January 1, 2026. The new designation covers an expanded area.

Unique Characteristics of the SCVEZ

- In 2009, the Santa Clarita Valley Economic Development Corporation (SCVEDC) was founded to support key initiatives, such as the SCVEZ, and conduct business retention, recruitment, and development activities.
- The County of Los Angeles has outlined extensive commitments in support of the SCVEZ.
- SCVEDC actively recruits firms in the following industries: Aerospace, Digital Media and Entertainment, Advanced Manufacturing, Medical Devices, and Information Technology.
- There is no existing business registry in Santa Clarita Valley. This is currently not a requirement by the City, per SCVEZ management.
- SCVEZ processed over 1,800 voucher applications during the audit period, January 1, 2012 through December 31, 2012.
- SCVEZ charges \$93 per voucher application. Seventy-eight dollars is retained by the EZ and \$15 is sent to HCD.

Audit Objectives

The HCD auditors evaluated SCVEZ’s performance towards meeting the goals, objectives, and commitments, as stated in their MOU with HCD. At the conclusion of the audit process, a performance score was determined, based on SCVEZ’s documentation supporting its achievement of goals and objectives related to EZ administration, marketing, budgeting, vouchering, and other relevant activities [GC Section 7076.1(b)]:

- Determine whether the SCVEZ Program is effective in the delivery of EZ Program goals, objectives, and commitments.
- Determine whether the SCVEZ is submitting reports timely and sufficiently managing its required responsibilities.
- Determine a performance score of superior, pass, or fail based on an evaluation of the SCVEZ Program activities, responsibilities, and other factors contributing to the SCVEZ Program performance.
- Assess compliance with EZ Act, California Code of Regulations, and HCD authorized procedures.

Audit Authority and Guidance

- Government Code Section 7070
- California Code of Regulations, Title 25, Division 1, Chapter 7, Subchapter 21, Articles 1-14
- California RTC Code Section 17053.74
- HCD Management Memos

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- HCD Application for Designation Guidebook and EZ Monitoring Guidebook
- SCVEZ Application for Designation
- SCVEZ established policies and procedures
- Internal control best practices

EZ Audit Scope

- SCVEZ Application, MOU and MOU Supplement
- SCVEDC performance reports
- SCVEZ Biennial report
- Voucher process and periodic monthly reports
- Activities and documentation available for the audit period

Audit Methodology

- Review Government Code Section 7070, California Code of Regulations, HCD guidance on reporting requirements
- Review SCVEZ application, MOU, MOU Supplement and corresponding exhibits
- Review SCVEZ self-evaluation report, biennial report, and monthly reports
- Review program policies and procedures, and locally maintained documentation
- Interview SCVEZ personnel
- Review SCVEZ website and partner websites

Audit Sampling Methodology

1. **Voucher Program** – To select the sample for testing, specific parameters were defined for voucher applications that were approved or denied during the period January to December 2012.
 - Of the 1,826 voucher applications received from January to December 2012, HCD auditors identified 70 applications from all qualifying categories (A-K) for testing. The 70 voucher applications were tested to determine if they met regulatory requirements.
 - For each category with less than five total applications, all were tested. For categories with over five applications, 20 percent of the population was selected. For category K, with a population of 1,248, a total of up to 30 applications were selected.
 - Voucher number sequence was verified to determine if voucher numbers were appropriately issued.
2. **Monthly Reporting** - comparison of January to December 2012 monthly reports to cashier logs, to determine if fees submitted were accurate. HCD EZ auditors verified the monthly report due dates and compared that information to the actual submittal date, to determine report timeliness.
3. **MOU Supplement and Self-Evaluation** - support documentation was compared to MOU goals, objectives, and commitments to determine the level of achievement.

Santa Clarita Valley Enterprise Zone's Performance Score and Adequacy of Controls

Performance Score: Pass

The audit performance score was based on SCVEZ documentation supporting the achievement of its goals, objectives and commitments relative to EZ administration, marketing, budgeting, vouchering, accomplishments, responsibilities, and control measures.

Note: The audit score achieved by a G-TEDA (EZ) is governed by CCR Section 7076.1, with the G-TEDA being able to achieve a score of: Superior (100 percent), Pass (99 to 75 percent) or Fail (< 75 percent). A G-TEDA audit score of less than 75 percent (below 75 percent in meeting goals, objectives, and commitment) will require a formal agreement between HCD's EZ Program and G-TEDA. The agreement will be for a maximum of 180 days, by the end of which all audit findings must be remediated to retain their Enterprise Zone designation.

Adequacy of Controls

The audit of the SCVEZ showed that there are areas of the operations that can be improved. This is evidenced by the level of compliance with regulations, MOU, and HCD policies and procedures.

Auditors noted that the following controls exist:

1. All voucher applications are approved by the EZ manager.
2. Roles and responsibilities of the EZ staff are defined.
3. Voucher processing policies and procedures exist, and are being followed.
4. Voucher records are retained for five years.
5. Monthly reports and fees are sent timely to HCD.
6. SCVEDC, who partners with SCVEZ for business expansion, attraction, retention, and marketing/sales strategies, is tracking achievements made in these areas and reporting this information for compliance with SCVEZ's MOU.

SCVEZ could improve operations in the following areas:

1. Budget projections and actual expense comparison.
2. In-kind commitments and supporting documentation to SCVEZ by business partners.
3. Biennial Reporting compliance.
4. Voucher log administration.
5. EZ management of administrative tasks and monitoring controls.

Santa Clarita Valley Enterprise Zone

Audit Finding Log

This is SVCEZ's log of audit findings. An audit finding includes the compliance or control issue, how the issue was noted, and the criteria/risk that should be complied with or managed and the suggested recommendations. The Audit Finding Log records SCVEZ's Action Plan, documentation requirements, the Action Owner, and the estimated Action Plan completion date.

A G-TEDA audit score of 99 to 75 percent will require that HCD EZ Audit team track all audit findings for resolution and submission of completion documentation. The EZ Audit team may also perform follow-up testing.

#	Issue/Significance (Risk)/Root Cause	Action Plan	Action Owner	Estimated Completion Date
1	<p><u>Operating Budget</u></p> <p>At the start of the audit, the budget was not well structured. After discussions on HCD's expectations, SCVEZ provided improved budget information.</p> <p><u>Criteria</u> 7076.1; 9/10/12 HCD memo; MOU#8 D; Application for Designation Guidebook; Monitoring Guidebook/Departmental Notification</p> <ul style="list-style-type: none"> Without prior written approval, the EZ shall not reduce the budget, staff allocation or modify subcontracts to communities or agencies or community organizations identified in the application when providing Santa Clarita Valley Enterprise Zone services. Identification of previous 2 years' funding for cash and in-kind. This should also include current and following fiscal year (FY). Any substantive changes to staffing levels or financial commitments must be reported to HCD. 	<ol style="list-style-type: none"> Cash contributions will be reflected in the SCVEZ's operating budget which will be submitted to HCD/SPA/EZ Audit Unit. Any revisions to commitments will be reported to HCD/SPA/EZ Audit Unit. SCVEZ will accurately report current status of all monies received by SCVEZ. Any commitment in the MOU will be tracked and reported to HCD/SPA/EZ Audit Unit. 	<p>Andree Walper</p> <p>Andree Walper</p>	<p>June 30, 2013</p> <p>June 30, 2013</p>

#	Issue/Significance (Risk)/Root Cause	Action Plan	Action Owner	Estimated Completion Date
	<p><u>Finding</u> The audit identified \$112,500 annual cash contributions to SCVEZ from different sources. This amount was no longer included in the last 2 FY budgets. SCVEZ revenue comes from vouchers only, per EZ manager.</p> <p><u>Recommendations</u> SCVEZ must implement appropriate controls to be able to account for cash contributions per MOU agreement. Actual commitments must be verifiable.</p> <ol style="list-style-type: none"> 1. Cash contributions should be reflected in SCVEZ's operating budget. If this commitment is no longer valid, it must be reported to HCD. 2. SCVEZ must evaluate true standing of all monies received by SCVEZ. A tracking tool must be implemented to effectively deliver on the commitment stated in the MOU. SCVEZ must be able to accurately report current status to the HCD. 			
2	<p><u>In-Kind Contributions</u></p> <p><u>Findings</u></p> <ol style="list-style-type: none"> 1. In reviewing the MOU Supplement, the auditors note the following: <ul style="list-style-type: none"> • Exhibit 6 - a total of \$21 million cash and in-kind contributions annually to SCVEZ (includes \$112,500 cash contributions noted above). • Exhibit 36 – unclear references to other budget revenue. • Exhibit 38 - lists participating jurisdictions' in-kind contributions. This includes \$2.5 million in commitments from the City of Santa Clarita and County of Los Angeles. 	<ol style="list-style-type: none"> 1. SCVEZ will measure and report in-kind contributions to HCD/SPA/EZ Audit Unit: <ol style="list-style-type: none"> a. SCVEZ has implemented a time tracking log for City of Santa Clarita EZ staff and for SCVEDC staff that regularly contribute to SCVEZ activities that will be maintained to confirm staff time commitments. b. SCVEZ will implement a tool for SCVEZ partners who have committed to contribute a percentage of their staff time towards SCVEZ activities to self-certify and confirm SCVEZ partner staff time in-kind commitments. 	Andree Walper	June 30,2013

#	Issue/Significance (Risk)/Root Cause	Action Plan	Action Owner	Estimated Completion Date
	<p>2. There was no system in place to track SCVEZ' in-kind contributions. Auditors were unable to verify if MOU commitments are on target.</p> <p><u>Recommendations</u> SCVEZ must be able to measure in-kind contributions and be able to accurately report current status to HCD.</p> <p>1. SCVEZ must implement necessary tools such as a time tracking log/spreadsheet for:</p> <ul style="list-style-type: none"> Staff time for City of Santa Clarita employees and SCVEDC staff contributing regularly to SCVEZ activities. A separate tracking tool must be used for other SCVEZ partners who periodically contribute their time towards SCVEZ activities (e.g. Chamber of Commerce, College of the Canyons). <p>2. SCVEZ must implement appropriate controls to be able to account for in-kind contributions per MOU agreement. Actual commitments must be verifiable.</p>	<p>c. SCVEZ will implement a tracking log of other non-staff in-kind contributions from SCVEZ partners that will be maintained to confirm in-kind commitments.</p> <p>2. As detailed above, SCVEZ will implement appropriate controls to track status of commitments to in-kind contributions to the SCVEZ.</p> <p>This is a < 75% score post revised regulations. Any changes to the budget must be approved by HCD.</p>	Andree Walper	June 30, 2013
3	<p><u>Biennial Report</u></p> <p>Although Biennial Reporting is a requirement, HCD issued guidance that allowed the EZs to do minimal performance reporting on goal and objective achievements.</p> <p>SCVEZ provided support documentation on achievements and specific activities that the EZ have completed, are ongoing, and plan on doing towards meeting its MOU goals, objectives, and commitments. However, this information was not included in the biennial report.</p>	<p>1. Beginning with the 2014 SCVEZ biennial report and all subsequent biennial reports will include all required components including budget, Business Expansion Attraction and Retention (BEAR) activities, job placements, and key performance indicators.</p> <p>2. Government code requirements and regulations will be reviewed prior to preparing a biennial report.</p>	Andree Walper	N/A

#	Issue/Significance (Risk)/Root Cause	Action Plan	Action Owner	Estimated Completion Date
	<p><u>Criteria</u> 7076.1; 9/10/12 HCD memo; 11/10/10 HCD memo</p> <ul style="list-style-type: none"> The biennial report should include activities relative to the goals, objectives, and commitments as stated in the original application for designation and MOU. Identification of previous 2 years' funding for cash and in-kind. This should also include current and following FY. <p><u>Findings</u> 1. SCVEZ' latest biennial report did not include the required regulatory components.</p> <ul style="list-style-type: none"> The report lacked information relative to the efforts outlined in the MOU towards goals, objectives, and commitments. The report lacked budget information. The report lacked a full description of performance activities and measures. <p><u>Recommendation</u> 1. SCVEZ must ensure that required components of the biennial report, and all parts of the MOU, are addressed and reported to meet regulatory requirements. SCVEZ should have steps in place to ensure achievements and performance measurements, including budget, Business Expansion Attraction and Retention (BEAR) activities, job placements, and key performance indicators are reported. 2. Government code requirements and regulations should be periodically reviewed for accurate reporting.</p>			
4	<p><u>Voucher Administration</u></p> <p>Voucher processing inaccuracies were identified during the voucher process review.</p>	1. SCVEZ administration will implement an online voucher system, SCVEZ On-Line Vouchering System. The new system will issue the voucher	Andree Walper	June 30,2013

#	Issue/Significance (Risk)/Root Cause	Action Plan	Action Owner	Estimated Completion Date
	<p>SCVEZ voucher administration is handled mainly by one person. Although the vouchers are approved by the EZ manager, records are maintained solely by the vouchering agent. There are no periodic reviews/spot checks by the supervisor to determine accuracy of records.</p> <p><u>Criteria</u> California Code of Regulations Title 25 Section 8463, HCD Management Memo 11/13/12, MOU</p> <ul style="list-style-type: none"> EZ shall sequentially number vouchers issued in the allocation provided. Vouchers are adequately controlled and accounted for in a vouchering system. Compliance with Article 14 shall be evaluated as part of any EZ audit. <p><u>Findings</u></p> <ol style="list-style-type: none"> Audit analysis of the voucher log and representative test sample of voucher applications showed the following errors: <ol style="list-style-type: none"> two voucher numbers being used twice missing voucher number from the log out of sequence voucher numbering miscount of denied applications support document for a qualifying category did not specify a timeframe to deem the employee eligible The vouchering process lacked a review process to periodically catch errors. Voucher records retention appeared to be compliant and reflected in voucher policies and procedures but city records retention schedule provided by SCVEZ did not include vouchers. 	<p>numbers in sequence for all vouchers to avoid duplication or skipped voucher numbers. The new system will properly calculate the number of vouchers to be issued and denied. Screenshots of this new system will be provided to HCD/SPA/EZ Audit Unit.</p> <ol style="list-style-type: none"> Through the new online voucher system, management will have the ability to pull reports and select vouchers to be reviewed for spot checking. The SCVEZ will adhere to the retention schedule that HCD has provided to retain documents for a minimum of five years that HCD has provided for the vouchers only. <p>The SCVEZ will create a spreadsheet to document all the voucher numbers that are purged after a minimum of five years and will include the time frame they cover. A copy of the first spreadsheet will be provided to HCD/SPA/EZ Audit Unit.</p>	<p>Andree Walper</p> <p>Andree Walper</p>	<p>June 30, 2013</p> <p>June 30, 2013</p>

#	Issue/Significance (Risk)/Root Cause	Action Plan	Action Owner	Estimated Completion Date
	<u>Recommendations</u> 1. SCVEZ management should implement appropriate measures to improve the accuracy and effectiveness of the voucher administration. 2. SCVEZ management should perform "exception" tests, such as spot checks or reviews. 3. SCVEZ management must include the voucher retention schedule in current city retention schedule or develop a records retention schedule for the vouchers only. When voucher records are purged after five years, such as those processed in 2007, SCVEZ should document voucher number applications that will be destroyed and the timeframe covered.			
5	<u>Administrative Tasks</u> SCVEZ operations could be improved. It is HCD's expectation that SCVEZ has created and maintains internal controls that help ensure the efficiency and effectiveness of EZ required responsibility. There are operational risks if there is a lack of internal controls in place to achieve a desired goal. With weak internal controls come increased operational risks in the areas of operational efficiency and effectiveness. <u>Criteria</u> Best Practices, Accounting Principles, COSO Internal Controls <ul style="list-style-type: none"> • Develop budgets in order to monitor progress toward EZ goals, predict voucher cash flow, and MOU commitment delivery. • Develop a process to reconcile staff commitments in MOU against staff's actual performance to ensure consistency. • Develop procedures to ensure that budget and staff time tracking are appropriately aligned with MOU commitments. 	1. SCVEZ will implement budget and cash flow projection reports and a regular comparison of budget against actual expenses. The budget and comparison will be sent to HCD/SPA/EZ audit unit. 2. SCVEZ has instituted time tracking for EZ and SCVEZ staff. Logs have been sent to HCD, and will additionally be sent to SPA/EZ Audit Unit. 3. SCVEZ will develop necessary policies and procedures and send them to HCD/SPA/EZ Audit Unit.	Andree Walper Andree Walper Andree Walper	June 30, 2013 June 30, 2013 June 30, 2013

#	Issue/Significance (Risk)/Root Cause	Action Plan	Action Owner	Estimated Completion Date
	<p><u>Findings</u></p> <ol style="list-style-type: none"> 1. At the time of the audit, operating budget for FY 12-13 was unclear. Although this has been discussed with EZ management and updated budget documentation has been received, auditors note a weakness in this area that should be addressed. 2. The MOU Supplement noted a specific percentage of time that would be spent by EZ staff and other city employees contributing to specific EZ activities. At the time of the audit, there was no clear way to track how much time the staff spent on a particular activity. 3. The EZ has are no specific policies and procedures to address budget, and staff time tracking. <p><u>Recommendations</u></p> <p>SCVEZ management must implement internal controls that provide reasonable assurance that goals and objectives, as stated in the MOU with HCD, are achieved. These would include:</p> <ol style="list-style-type: none"> 1. SCVEZ must implement budget and cash flow projection reports and a regular comparison of budget against actual expenses. Any significant discrepancies must be investigated and reported to HCD. 2. SCVEZ must develop EZ staff time tracking tools to be able determine whether target goals are being met. 3. SCVEZ must develop necessary policies and procedures to ensure all of the above are addressed and steps are consistently followed. 			

Audit Observation

The SCVEZ provided support documentation as evidence of the EZ's ongoing or completed activities in the last two years, towards meeting its goals, objectives and commitments. Annual reports, performance measures, action plans, and specific support documentation on job retention, jobs attracted and retained, all seem to indicate that commitment delivery in these areas, per MOU, were on track. Additional documentation was submitted in support of future activities planned for the economic development of Santa Clarita Valley. HCD auditors note the significant participation by the SCVEDC, a major partner of SCVEZ, in providing most of the support documentation for SCVEZ's achievement of commitments, per its MOU. SCVEDC's strategic planning incorporates an assessment of current economic and business conditions, establishes a clear mission, objectives and action plan to fulfill that mission, and measure its performance. Nevertheless, given the magnitude and importance of the EZ Program and risk of dedesignation that non-compliance with regulations represents, SCVEZ operations could be stronger by implementation of suggested recommendations. SCVEZ's adoption of suggested changes will align with commitments made in the MOU.

One area that would need evaluation by SCVEZ is the contributions received from the City of Santa Clarita, the County of Los Angeles, and other entities in terms of cash and in-kind commitments as stated in the MOU. Per HCD's Application for Designation Guidebook, staffing commitments should be verifiable. With commitments valued in the millions of dollars, this might be a time-consuming effort to track. This topic is worth discussing with HCD to reach an understanding. Failure to resolve this issue could have significant impact under the proposed regulatory changes.

In addition, SCVEZ did not have information on the total number of businesses in the SCVEZ to compare to the actual number of businesses in SCVEDC's database. If a full picture of the market is available, it will help focus SCVEZ activities on specific areas and be able to measure achievements against the total targeted population.

HCD's audit of the SCVEZ brought to light an HCD decision that is noteworthy:

1. The audit cited SCVEZ for a non-compliant biennial report. SCVEZ, however, provided a copy of a memo from the California Association of Enterprise Zones President, sent to all EZs dated September 21, 2012, stating, "HCD has agreed to accept this brief report as satisfying the reporting requirement in full". The regulations are clear on the expectations for biennial reporting. HCD's EZ Program should ensure that the regulations are adhered to and consistently followed.